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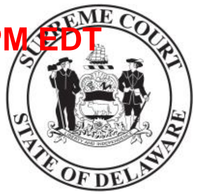

IN THE SUPREME COURT OF THE STATE OF DELAWARE

NICHOLAS OLENIK, Individually and on Behalf of All Others Similarly Situated, Plaintiff-Below, Appellant, v. FRANK A. LODZINSKI, RAY SINGLETON, DOUGLAS E. SWANSON, BRAD THIELEMANN, ROBERT L. ZORICH, JAY F. JOLIAT, ZACHARY G. URBAN, ENCAP INVESTMENTS L.P., BOLD ENERGY III LLC, BOLD ENERGY HOLDINGS LLC and OAK VALLEY RESOURCES, LLC, Defendants-Below, Appellees, and EARTHSTONE ENERGY, INC, a Delaware corporation, Nominal Defendant-Below, Appellee.	No. 392, 2018 Court Below: Court of Chancery of the State of Delaware C.A. No. 2017-0414-JRS PUBLIC VERSION FILED OCT. 30, 2018

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Dated: October 15, 2018

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NATURE OF PROCEEDINGS

This is an appeal from the Court of Chancery's order dismissing Plaintiff's lawsuit, which challenged a combination between Earthstone Energy, Inc. and Bold Energy III LLC (the "Transaction"). The Transaction was approved by an independent special committee of Earthstone directors (the "Special Committee") and a nearly unanimous majority of the disinterested holders of Earthstone's stock. Dismissal was appropriate because, among other reasons, (1) Plaintiff failed to allege that Defendants did not satisfy the framework established in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635, 645 (Del. 2014) ("*MFW*"), *overruled in part on other grounds*, *Flood v. Synutra Int'l, Inc.*, No. 101, 2018, 2018 WL 4869248, at *10 n.81 (Del. Oct. 9, 2018) ("*Synutra II*"); and (2) Plaintiff failed to allege that a controller stood on both sides of the Transaction, and stockholders approved it in a fully informed vote. B168–71. The Court of Chancery did not determine whether Plaintiff adequately alleged control because it correctly determined "that Earthstone's decision to employ the *MFW* framework was well-executed by all concerned," and thus "business judgment deference is the appropriate standard by which to evaluate the Transaction, even at the pleadings stage." *Olenik v. Lodzinski,* 2018 WL 3493092, at *14 (Del. Ch. July 20, 2018).

On appeal, Plaintiff challenges the court's application of *MFW*, arguing that (1) the court misapplied *MFW*'s *ab initio* requirement; (2) the Special Committee

failed to act with due care; and (3) the proxy statement (the "Proxy") was materially incomplete. Those arguments fail.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery properly applied *MFW*'s *ab initio* requirement, concluding that the *MFW* protections were in place before negotiations began. The Special Committee's imposition of the *MFW* protections in the initial offer letter was sufficient because it made clear to Bold and EnCap (which owned Bold and indirectly owned an interest in Earthstone)—before any economic horse-trading began—that the Transaction would be subject to those terms. Plaintiff asks the Court to unreasonably infer that preliminary discussions constituted actual bargaining, and thus that the *MFW* protections should have been imposed sooner. But the Complaint alleges no back-and-forth on economic terms prior to the initial offer letter and abundant back-and-forth on economic terms following it. There can be no question that the alleged controller did not dangle the *MFW* conditions as a substitute for offering better economic terms. This Court recently rejected an overly-literal interpretation of "*ab initio*" similar to the one Plaintiff proposes here (*i.e.*, "from the very beginning to the very end," Op. Br. at 22), and the Court should again decline to create an *MFW* "tripwire"' that executives can unwittingly trigger by engaging in preliminary discussions and diligence regarding potential transactions. *See Synutra II*, 2018 WL 4869248, at *4–*9.

2. Denied. The Court of Chancery correctly held that the Special Committee acted with due care by meeting sixteen times, diligently studying various proposals and financial analyses, and actively directing negotiations. Reflecting the market's favorable perception of the Special Committee's efforts, Earthstone's stock price increased 67% in the months after the Transaction was announced, and 99.8% of the unaffiliated stockholders who voted on the Transaction cast their votes in favor. Plaintiff abandons most of his "due care" allegations on appeal and attempts to impugn the Special Committee's process solely by alleging that Lodzinski (Earthstone's CEO) was involved in negotiations, but Plaintiff inadequately alleges Lodzinski was conflicted or was not being properly supervised by the Special Committee. According to Plaintiff, Lodzinski owed fiduciary duties to EnCap because EnCap has an ownership interest in Oak Valley Resources, and Lodzinski is an Oak Valley director. But Plaintiff does not—and cannot—rebut the undisputed fact that Oak Valley's interests were aligned with Earthstone's interests in the Transaction, as *Oak Valley was a significant Earthstone stockholder but owned no Bold stock*. As a matter of law, the allegation that Lodzinski owed fiduciary duties to Oak Valley's owners (including EnCap) does not mean that Lodzinski had a duty to favor EnCap over Oak Valley or Earthstone in the Transaction—quite the opposite. And allegations

regarding Lodzinski's alleged "long relationship" with EnCap do not adequately allege that he had a material conflict in the Transaction.

3. Denied. The Court of Chancery correctly held that the Proxy sufficiently disclosed all material information about the Transaction, providing nearly 400 pages of information. The two disclosure allegations Plaintiff raises on appeal are premised on inferences of improper motives. For instance, according to Plaintiff, the Proxy should have disclosed that the Special Committee asked its financial advisor to add a row listing 2019 projections to one of its charts, as the chart initially included only 2017 and 2018 projections. Because the 2019 projections showed favorable numbers for Bold, Plaintiff accuses the Special Committee and its financial advisor of skewing their analyses to support the Transaction. But the Special Committee's request is not remarkable, let alone material or nefarious, particularly given the deal thesis of the Transaction (*e.g.*, Earthstone was acquiring Bold's long-term upside). Plaintiff similarly alleges that the Proxy should have disclosed EnCap's purported motive to sell Bold due to Bold's short-term liquidity needs. But the Proxy discloses that Bold had recently gone through a formal sales process, and it contains extensive financial information concerning Bold's liquidity situation. Nothing further was required.

4. Alternatively, this Court should affirm the Court of Chancery's judgment because Plaintiff failed to allege that EnCap or Oak Valley controlled

Earthstone. The Complaint concedes that Oak Valley (which did not stand on both sides of the Transaction) and EnCap (which indirectly did) were not, in the aggregate, Earthstone's majority owners during the entire course of the Transaction. Indeed, EnCap and Oak Valley's aggregate ownership interest had dropped to 41.1% before Earthstone's submission of its initial proposal. A60. Because EnCap and Oak Valley undisputedly did not own more than 50% of Earthstone at all relevant times, Plaintiff must—but fails to—adequately plead they exerted "such formidable voting and managerial power that they, as a practical matter, are no differently situated than if they had majority voting control." *In re PNB Holding Co. S'holders Litig.*, 2006 WL 2403999, at *9 (Del. Ch. Aug. 18, 2006). This test "is not an easy one to satisfy," *id.*, and it is not satisfied with Plaintiff's attenuated allegations that EnCap controlled Earthstone through Lodzinski.

COUNTERSTATEMENT OF FACTS

A. The Parties

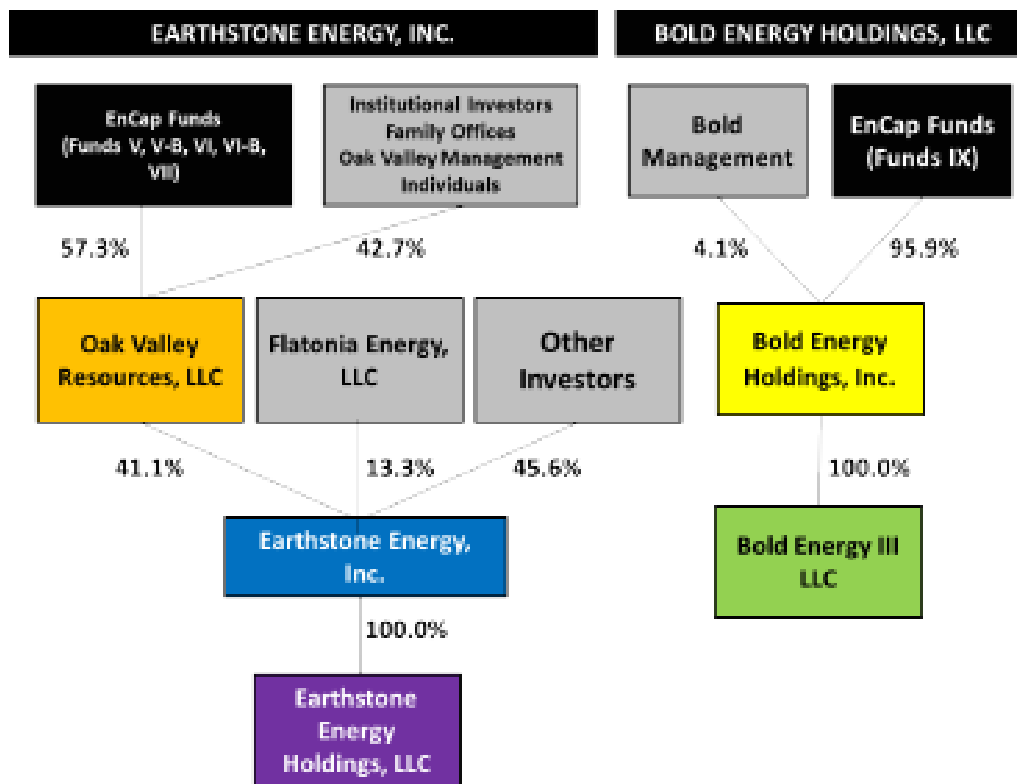
Earthstone is a Delaware corporation engaged in the "acquisition and development of onshore crude oil and natural gas reserves." A53. Earthstone is managed by its Board of Directors (the "Board"), which—until the Transaction—consisted of Lodzinski, Singleton (an Earthstone EVP), three managing partners at EnCap (Swanson, Thielemann, and Zorich), and three directors who have no affiliation with Earthstone or EnCap: Joliat, Urban, and Kramer. A50–52.

Bold was formed in March 2013 and "owns significant developed and undeveloped oil and natural gas properties," including [redacted] in the core of the Midland Basin of Texas" (by comparison, Earthstone had only [redacted] in this coveted basin). A49–50, 66–67, 246, 299. At the time of the Transaction, Earthstone was a small, mature company with minimal inventory that could be developed at current commodity prices; by contrast, Bold had significant undeveloped resources that could be tapped for growth:

	Earthstone	Bold
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]

A266. In other words, Earthstone was presently producing more hydrocarbons and revenues, while Bold's long-term upside was higher. A262–63.

EnCap is a private equity firm that owns indirect interests in Earthstone and Bold. A49. EnCap did not directly own any Earthstone stock but held a 57.3% interest in Oak Valley, which owned 41.1% of Earthstone. A60. Thus, "EnCap through its investment entities indirectly owns 23.6% of Earthstone but may be deemed to own beneficially 41.1% of Earthstone." A246. EnCap also owned 95.9% of Bold's membership units. A66–67. Oak Valley did not have any ownership interest in Bold. A simplified pre-Transaction ownership structure follows:



B. Earthstone and Bold agree to the Transaction.

1. Management engages in preliminary discussions.

Earthstone has grown "from a micro-cap company to a small-cap company" through a strategy of "pursuing value-accretive corporate merger and acquisition opportunities." A62–64. In June 2015, a financial advisor identified for Earthstone several potential targets, including Bold. A290. In November 2015, Earthstone approached EnCap about possibly combining with Bold or other EnCap portfolio companies, which led to preliminary discussions between the managers of Earthstone, EnCap, and Bold. A68–69, 290. Earthstone management discontinued these preliminary discussions in January 2016 "due to [deteriorating] market conditions" in the energy sector. A71.

In April 2016, Earthstone management re-initiated conversations with Bold and EnCap and provided the Board with an update on "Current Deals Working," including the potential Bold transaction. A72–73 (quoting A740). As part of these conversations, Earthstone provided Bold with presentation materials that "indicate[d] an equity valuation for Bold of approximately $335 million." A77. On June 10, 2016, senior management from Earthstone and Bold held their first in-person meeting concerning a potential transaction. A78–79, 293.

2. Earthstone forms a Special Committee.

On July 8, 2016, Earthstone formed the Special Committee, which consisted of independent directors Joliat and Urban. A80, 293. The Special Committee's charter gave it power to:

> (1) determine whether or not to make a formal offer of combination with Bold and if so, the terms and conditions of such offer; (2) negotiate and oversee the documentation of any such offer; (3) retain its own financial advisor and legal counsel; (4) solicit the views of, and obtain information from, Earthstone's executive, financial and other officers; and (5) reject the potential transaction, cease further negotiations and "walk away."

A294. Although the charter was not formally adopted until July 29, 2016, the Special Committee began work on July 8, 2016. A80, 82. The Special Committee interviewed three law firms, selecting Richards, Layton, & Finger ("RLF"). A82. Soon thereafter, the Special Committee communicated with six financial advisors and selected Stephens, Inc. ("Stephens"). A87–88; 293–94.

3. The Special Committee evaluates, negotiates, and approves the Transaction.

From July to November 2016, the Special Committee formally met sixteen times. A294–98. The Special Committee kept "directors affiliated with EnCap...out of the flow of information" and thoroughly analyzed the work of its advisors. A84–85, 90. For instance, on August 16, 2016, the Special Committee met twice to "receive Stephens' preliminary financial analysis of a proposed

transaction," [redacted]. *Id.*; *see also* B36 (referenced in A88–90).

On August 19, 2016, the Special Committee met and, following thorough discussion, authorized Earthstone management—who were not affiliated with EnCap or Bold—to submit an initial written proposal for Earthstone to combine with Bold in a transaction valuing Bold at $325 million. A91, 295. This initial proposal—the first written proposal concerning a potential Earthstone/Bold transaction—stated that any agreement was conditioned upon the approvals of the Special Committee and a majority of the holders of Earthstone's common stock who were not affiliated with EnCap or Bold. A748. The offer would have resulted in a 55/45% Bold/Earthstone split of the combined entity.[1] A295.

Over the following weeks, the Special Committee evaluated the potential transaction, directed negotiations (with Lodzinski delivering messages to Bold at the Special Committee's direction), and requested additional analyses from Stephens and RLF. A96–98, 295–97. The parties ultimately agreed to a transaction with a 61/39% split. A99–100.

On November 7, 2016, Stephens presented its final analysis to the Special Committee, concluding that "the consideration to be paid by the Company was fair to the Company and its public stockholders from a financial point of view."

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[1] Percentage splits referenced in this brief list Bold's percentage, followed by Earthstone's.

A100–01. [redacted]

[redacted]

[redacted] After receiving Stephens' analysis, the Special Committee unanimously recommended approval of the Transaction to the Board, and the full Board unanimously approved it. A100–01. Soon thereafter, Earthstone entered into a Contribution Agreement memorializing the Transaction.

C. The holders of a majority of disinterested stock approve the Transaction.

On May 9, 2017, Earthstone's disinterested stockholders almost unanimously approved the Transaction. B88–89. Of the stock that was voted at the special meeting, approximately 99.8% of unaffiliated stock voted to approve the Transaction; this equates to 70.9% of all outstanding unaffiliated stock. *Id.* When including the EnCap-affiliated votes, 99.9% of voting stockholders (and 83.5% of outstanding stock) voted in favor. *Id.*

ARGUMENT

I. The Court of Chancery correctly held that *MFW*'s dual protections were in place *ab initio*.

A. Question Presented

Whether the Court of Chancery correctly held that *MFW*'s dual protections were in place *ab initio* because Earthstone conditioned the Transaction on the approval of both the Special Committee and the holders of a majority of Earthstone's disinterested stock in its initial offer letter before substantive economic negotiations began. B210–13, B257–261.

B. Scope of Review

This Court's review of a trial court's grant of a motion to dismiss is *de novo*. *Caspian Alpha Long Credit Fund, L.P. v. GS Mezzanine Partners 2006, L.P.,* 93 A.3d 1203, 1205 (Del. 2014).

C. Merits of the Argument

The Court of Chancery correctly dismissed Plaintiff's lawsuit because the Transaction was "conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders." *MFW*, 88 A.3d at 644. Earthstone's initial offer was expressly conditioned on "final approval by Earthstone's Special Committee" and "formal approval of Earthstone's stockholders, including the holders of a majority of the common stock

held by persons [not affiliated with EnCap or Bold]." A748. "By conditioning the first offer in this manner, the Special Committee made clear to Bold and EnCap that the 'procession of the transaction' would be subject to these terms. That is precisely what *MFW* requires." *Olenik*, 2018 WL 3493092, at *15 (quoting *MFW*, 88 A.3d at 645).

Plaintiff disputes the trial court's application of *MFW* by misconstruing the *ab initio* requirement (*infra* §I.C.1); mischaracterizing the parties' pre-offer communications as "negotiations" (*infra* §I.C.2); inferring that EnCap did not accept the *MFW* conditions (*infra* §I.C.3); and arguing that the trial court should have considered some, but not all, of Earthstone's initial offer letter (*infra* §I.C.4). As explained below, none of Plaintiff's arguments justifies reversal.

1. The Court of Chancery properly applied *MFW*'s *ab initio* requirement.

The Court of Chancery faithfully applied *MFW*'s framework, holding that the *MFW* protections must be in place "'before any negotiations [take] place.'" *Olenik*, 2018 WL 3493092, at *15 (quoting *In re Synutra Int'l, Inc.*, 2018 WL 705702, at *2 (Del. Ch. Feb. 2, 2018) ("*Synutra I*"), *aff'd*, *Synutra II*. Plaintiff contends that this was legal error and interprets *ab initio* to mean "from the very beginning to the very end." Op. Br. at 22. But this Court has, on two occasions, (1) foreclosed Plaintiff's "cramped reading" of *MFW*; and (2) affirmed that the Court of Chancery applied the proper standard, explaining that the *MFW*

protections must be in place "before substantive economic negotiation [takes] place." *Synutra II*, 2018 WL 4869248, at *6, *8; *Swomley v. Schlecht*, 2014 WL 4470947, at *21 (Del. Ch. Aug. 27, 2014), *aff'd*, 128 A.3d 992 (Del. 2015) (TABLE).

2. The trial court correctly held that Earthstone imposed the *MFW* conditions before substantive economic negotiations occurred.

Nor did the Court of Chancery err in holding that Earthstone imposed the *MFW* conditions before substantive economic negotiations began. *Olenik*, 2018 WL 3493092, at *15–16. Plaintiff's theory—that preliminary discussions between the parties were substantive economic negotiations—is contrary to applicable case law and requires the Court to indulge in unreasonable inferences. Op. Br. at 24–28.

"Substantive economic negotiations" occur when the parties are engaged in "economic horse ***trading***." *Synutra II*, 2018 WL 4869248, at *1. Even the delivery of a formal offer letter does not constitute "negotiations" until (at the very earliest) the counterparty ***responds***, as this Court recently established by finding that a controller's initial offer letter did not constitute "negotiations" where the counterparty did not respond until after the controller sent a second letter. *Id.* at *8–*9. Discussions between the parties are also insufficient. *See In re Books-A-Million, Inc. S'holders Litig.*, 2016 WL 5874974, at *2, *8 (Del Ch. Oct. 10, 2016)

(*MFW* requirements satisfied where proposal contained the conditions, even though parties had "discussed a potential business combination" "[a]t various times during the last four years"), *aff'd*, 164 A.3d 56 (Del. 2017) (TABLE); *see also MFW*, 88 A.3d at 640; *In re Martha Stewart Living Omnimedia, Inc. S'holder Litig.*, 2017 WL 3568089, at *18 (Del. Ch. Aug. 18, 2017). Indeed, "no dictionary references are needed to know that to 'negotiate' means to bargain toward a desired contractual end, whereas to 'discuss' means merely to exchange thoughts and points of views on matters of mutual interest, with no ***bargaining*** overtones necessarily involved." *Colonial Sch. Bd. v. Colonial Affiliate, NCCEA/DSEA/NEA*, 449 A.2d 243, 247 (Del. 1982) (emphasis added). Consistent with these principles, the Court of Chancery concluded that the *MFW* conditions were in place before economic bargaining began. *Olenik*, 2018 WL 3493092, at *16 (initial offer was "followed by more than two months of negotiations between the Special Committee and Bold that included several attacks, parries and remises before a final deal was struck").

The Complaint does not adequately allege that substantive economic negotiations occurred before the Special Committee sent the first offer (which imposed the *MFW* conditions) on August 19, 2016. Plaintiff points to preliminary communications about valuations of Bold, corporate models, asset valuations, the asset and divestiture market, an action plan for a "possible transaction," and the

equity market's likely receptivity to a transaction, Op. Br. at 26–27, but nothing in these preliminary discussions suggests economic bargaining. These discussions contained no offers or counteroffers. Plaintiff makes much of two Earthstone "presentation[s]…that ***indicated*** an equity valuation for Bold of" $305 million (in the first presentation) and $335 million (in the second presentation, which was updated to reflect Bold's recently-acquired acreage). A76–77, 292. There are no allegations suggesting these presentations constitute substantive economic bargaining rather than preliminary discussions.[2] Plaintiff never alleges that EnCap or Bold rejected the $305 million "valuation," asked for a higher valuation, or proposed their own valuation. Rather, Plaintiff alleges only that "EnCap indicated it would review Earthstone's valuations with [Bold's financial advisor]." A77. That is insufficient to elevate exploratory discussions into negotiations. *See Synutra II*, 2018 WL 4869248, at *7 (holding that initial offer did not begin negotiations, and explaining that "[t]he essential element of *MFW*, then, is that these requirements cannot be dangled in front of the Special Committee, when ***negotiations to obtain a better price*** from the controller have commenced, as a substitution for a bare-knuckled contest over price" (emphasis added)).

[2] Even if these presentations could be construed as "offers," which they cannot, the facts would resemble *Synutra*: the initial offeror made an alleged "offer" (the May 2016 presentations) and then—prior to receiving a counteroffer—made another offer that contained the *MFW* conditions (the August 2016 letter).

Despite having received pre-suit discovery through Del. Code Ann. tit. 8, § 220, Plaintiff is thus left to ask the Court to *infer* that "negotiations or bargaining occurred" before August 19, 2016. Op. Br. at 27. But Delaware courts are neither "required to accept as true conclusory allegations...no[r] required to accept every strained interpretation of the allegations proposed by the plaintiff." *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006). Plaintiff's requested inference is particularly unreasonable given that the Complaint exhaustively details a series of "counteroffer[s]" and "counterproposal[s]" that Bold and the Special Committee exchanged ***after*** August 19, 2016, which stands in stark contrast to the utter lack of economic back-and-forth alleged ***before*** August 19, 2016. A76–80, 92–102.

Thus, as the court below correctly concluded, discussions prior to August 19, 2016, "while extensive, never rose to the level of bargaining; they were entirely exploratory in nature." *Olenik*, 2018 WL 3493092, at *16. As in *Synutra*, the *MFW* conditions were imposed prior to a counterproposal being made or any "horse trading" whatsoever.

Holding that such discussions constitute substantive economic negotiations would negate this Court's rejection of the "cramped" and "rigid" reading of *ab initio* to mean the "first approach...[must] contain the required conditions," even if they are in place "early on before any economic negotiations." *Synutra II*, 2018

WL 4869248, at *4–6; *supra* §I.C.1. The purpose of the *ab initio* doctrine is to ensure that the controller "cannot dangle a majority-of-the-minority vote before the special committee late in the process as a deal-closer rather than having to make a price move." *MFW*, 67 A.3d at 528; *accord Synutra II*, 2018 WL 4869248, at *6. Here, there is no allegation that EnCap "dangled" the *MFW* conditions "as a bargaining tool in substitution for economic concessions," *Synutra II*, 2018 WL 4869248, at *5. Thus, the parties imposed the *MFW* conditions early enough.

3. The trial court correctly concluded that Earthstone's imposition of *MFW*'s dual protections was sufficient.

Plaintiff cannot avoid dismissal by arguing that "EnCap never agreed to the *MFW* protections." Op. Br. at 30. Such an inference would be unreasonable. The Complaint concedes that (1) a Special Committee was formed, (2) the Special Committee sent the initial offer letter to Bold containing the *MFW* conditions, (3) Bold and the Special Committee then engaged in a two-month process of exchanging counterproposals, and (4) after its receipt of a fairness opinion, the Special Committee recommended the Transaction to the Board, which approved it. A80, 91–101. Further, Plaintiff acknowledges that the Transaction was approved by a "minority stockholder vote." Op. Br. at 8. Particularly given that the *MFW* conditions "add[] an element of transactional risk," it strains credulity to suggest that EnCap (and its portfolio company, Bold) would reject the *MFW* conditions yet proceed to negotiate for months with the Special Committee and submit the

Transaction to a majority-of-the-minority vote requirement.[3] *Synutra II*, 2018 WL 4869248, at *6 (quoting *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 618 (Del Ch. 2005)).

Plaintiff suggests EnCap never accepted the *MFW* conditions because Bold "rejected" the initial offer letter "by submitting a written counteroffer." Op. Br. 29. But it is hardly remarkable that Earthstone's initial offer letter was not accepted. That the parties bargained over price and other deal terms after the initial offer provides no basis to infer that Bold (or EnCap) rejected the *MFW* conditions. Plaintiff's invocation of elementary offer-and-acceptance contract law is inapposite: *MFW* decisions almost invariably describe counteroffers to proposals that contain the *MFW* conditions, yet no prior court has used the existence of a counteroffer to suggest that the *MFW* conditions were "rejected," and Plaintiff has pointed to no case in which a counterparty responded to a proposal by explicitly accepting the *MFW* conditions. *Cf. MFW,* 88 A.3d at 640-42, 652; *Books-A-Million,* 2016 WL 5874974, at *2-5; *Synutra I*, 2018 WL 705702, at *2-3, *6.

Plaintiff also takes snippets from *MFW* decisions to suggest that the alleged controller, and not the controlled party, must impose the *MFW* conditions. Op. Br. at 29. These snippets merely reflect that, in the typical *MFW* fact pattern, the

[3] Such a suggestion is even more implausible because the "first draft of the Contribution Agreement" included a provision "that the approval of a majority of disinterested stockholders also be obtained." A297.

controller makes the first overture; they do not hold anything whatsoever about which party must impose the *MFW* conditions. *Id.* If anything, the fact that Earthstone—rather than its alleged controller—initiated discussions and insisted on the *MFW* protections bolsters Defendants' position, not Plaintiffs' by (1) indicating Earthstone exercised autonomy over the timing and process of the Transaction, and (2) establishing the Special Committee did not accept the *MFW* conditions in lieu of improved economic terms. *See MFW*, 88 A.3d at 644. Indeed, this Court has affirmed that the *ab initio* requirement was satisfied where the company, rather than the controller, conditioned the transaction upon the *MFW* dual protections. *Swomley*, 2014 WL 4470947, at *21 ("It is true that the controller's initial proposal hedged on whether the majority-of-the-minority condition would be waivable or not, but from the first meeting, the board resolved that any deal would require both the approval of a special committee and a majority-of-the-minority vote.").

4. The trial court properly considered Earthstone's initial offer letter.

The trial court properly considered the initial offer letter both because (1) it is integral to the Complaint and (2) Plaintiff incorporated it by reference. "Without the ability to consider the document at issue in its entirety, 'complaints that quoted only selected and misleading portions of such documents could not be dismissed under Rule 12(b)(6) even though they would be doomed to failure.'" *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 169-70 (Del. 2006). Plaintiff is

engaged in exactly this sort of tactic, but he cannot delay the dispositive effect of *MFW* until summary judgment by tiptoeing around the initial offer letter in his Complaint.

Delaware courts may consider documents that are integral to the complaint—those that are the source for the facts pled in the complaint. *In re Gardner Denver, Inc. S'holders Litig.*, 2014 WL 715705, at *3 (Del. Ch. Feb. 21, 2014). Here, Plaintiff expressly relied on the letter (which he received on August 11, 2017—two months before filing his current Complaint) to allege the offer terms it conveyed. A91–92. Thus, it is integral to the Complaint, and the trial court properly considered it.

The cases Plaintiff cites ***support*** the trial court's consideration of the letter because each determined that a document was integral to a complaint. *See Gardner*, 2014 WL 715705, at *6 (deposition transcripts, website printouts, and SEC filings); *Allen v. Encore Energy Partners, L.P.*, 72 A.3d 93, 96 n.2 (Del. 2013) (proxy statement); *Gerber v. EPE Holdings, LLC*, 2013 WL 209658, at *1 n.12 (Del. Ch. Jan. 18, 2013) (partnership agreement); *e4e, Inc. v. Sircar*, 2003 WL 22455847, at *3 (Del. Ch. Oct. 9, 2003) (letter).

Even if the letter were not integral to the Complaint, the Court still properly considered it under the incorporation by reference doctrine. "A plaintiff may not reference certain documents outside the complaint and at the same time prevent the

court from considering those documents' actual terms." *Winshall v. Viacom Int'l, Inc.*, 76 A.3d 808, 818 (Del. 2013) (internal quotation marks and citations omitted). That is precisely what Plaintiff is attempting to do. Plaintiff relied on the letter to allege both that an offer was made and the terms of that offer, but he argues that the Court should have ignored that the offer was expressly conditioned on the dual protections of *MFW*. A91–92; Op. Br. at 31–33. The incorporation by reference doctrine forbids that result, and the Court properly dismissed the complaint because the remainder of the letter "effectively negate[s] [Plaintiff's] claim as a matter of law." *Gen. Motors*, 897 A.2d at 169.[4]

[4] Plaintiff also complains that Defendants did not produce the initial offer letter in response to his request for inspection of books and records, but that is irrelevant to the incorporation-by-reference doctrine. Regardless, the letter was not produced because Plaintiff's proposed production did not include it, and Plaintiff did not request offer letters after Earthstone's production, even though the letters were described in the Proxy. B75, 269. Finally, Plaintiff received the letter months prior to filing his current Complaint. A174.

II. Plaintiff has not adequately alleged that the Special Committee was grossly negligent.

A. Question Presented

Whether Plaintiff has adequately alleged that the Special Committee breached its duty of care due to Lodzinski's involvement in the process, considering Lodzinski's lack of a conflict and the undisputed facts that the Special Committee met sixteen times, analyzed a vast array of information related to the Transaction, and traded several counteroffers with Bold. B214–23, B262–65.

B. Scope of Review

This Court's review of a trial court's grant of a motion to dismiss is *de novo*. *Caspian Alpha*, 93 A.3d at 1205.

C. Merits of the Argument

To avoid dismissal under *MFW*, Plaintiff must—but fails to—adequately allege that the Special Committee breached its duty of care. *Synutra II*, 2018 WL 4869248, at *10–11; *Books-a-Million*, 2016 WL 5874974, at *17. Plaintiff had the burden to plead "gross negligence," which "is a difficult one," because "[g]ross negligence has been defined as 'conduct that constitutes *reckless indifference* or actions that are without the bounds of reason.'" *Zucker v. Hassell*, 2016 WL 7011351, at *7 (Del. Ch. Nov. 30, 2016), *aff'd*, 165 A.3d 288 (Del. 2017) (TABLE) (quoting *Espinoza v. Dimon*, 124 A.3d 33, 36 (Del. 2015)). Plaintiff has fallen far short of that standard and alleges little more than a disagreement with the

Special Committee's negotiation process. *See Swomley*, 2014 WL 4470947, at *21 (merely alleging that "[s]omebody could have negotiated that differently" does not suffice).

There can be little dispute that the Special Committee worked diligently to negotiate a fair price. It met sixteen times and analyzed a wide array of financial information about the Transaction, including Stephens' fairness opinion. A602–04. That is the exact type of diligence that *MFW* requires. 88 A.3d at 650, 653 (special committee met its duty of care when it "met frequently and was presented with a rich body of financial information relevant to whether and at what *price* a going private transaction was advisable."); *Synutra II*, 2018 WL 4869248, at *11 (gross negligence not adequately pleaded where the special committee engaged in "extensive deliberations, receipt of extensive advice and information from its financial and legal advisors, and negotiations"). And the Special Committee's efforts paid off. "Earthstone's stock price increas[ed] dramatically from $8.98 per share to $14.98 per share" in the months after the announcement of the Transaction (including a 29% increase the day after the announcement), A106; B3–5, which strongly indicates that the Special Committee's efforts resulted in a favorable Transaction for Earthstone's stockholders, *see C&J Energy Servs., Inc. v. City of Miami Gen. Emps.*, 107 A.3d 1049, 1063 (Del. 2014).

Because Plaintiff cannot attack the Special Committee's diligence, his "due care" appeal rests solely on the notion that Lodzinski's involvement constituted gross negligence. Op. Br. at 35–39. That argument fails for several independent reasons, as set forth below.

1. Lodzinski was not controlled by or beholden to EnCap.

Plaintiff's argument wrongly assumes Lodzinski was controlled by and beholden to EnCap. To adequately allege that a fiduciary lacks independence, "[t]here must be coupled with the allegation of control such facts as would demonstrate that through personal or other relationships the directors are beholden to the controlling person." *Aronson v. Lewis*, 473 A.2d 805, 815 (Del. 1984), *rev'd in part on other grounds*, *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000). This is a high bar: the allegedly controlling entity must have "the unilateral power...to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such subjective material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively." *Zimmerman ex rel. Priceline.com, Inc. v. Braddock*, 2002 WL 31926608, at *7 (Del. Ch. Dec. 20, 2002). Plaintiff falls far short of that standard.

Plaintiff focuses on Lodzinski's "long-relationship" with EnCap, citing EnCap's 2012 investment in Oak Valley. Op. Br. at 9, 36. But the standard looks to whether an entity has the ***present*** ability to deprive a director of a current benefit, not to past business transactions. *See Priceline.com, Inc.*, 2002 WL 31926608, at *7; *In re CompuCom Sys., Inc. Stockholders Litig.*, 2005 WL 2481325, at *8-9 (Del. Ch. Sept. 29, 2005); *Beam v. Stewart*, 845 A.2d 1040, 1050 (Del. 2004) ("Allegations of...a mere outside business relationship, standing alone, are insufficient....").

Similarly, Plaintiff's allegations about Lodzinski's "divided loyalties" fall flat. Op. Br. at 36. Plaintiff's false syllogism proceeds as follows: (a) Lodzinski is an Oak Valley director, (b) EnCap is an Oak Valley stockholder, and therefore (c) Lodzinski owed "competing fiduciary" duties to EnCap and Earthstone. *Id.* at 36. But Plaintiff ignores that Oak Valley directors (like Lodzinski) owe fiduciary duties to Oak Valley stockholders collectively, not to EnCap individually. *See Frederick Hsu Living Tr. v. ODN Holding Corp.*, 2017 WL 1437308, at *17 (Del. Ch. Apr. 14, 2017) (directors owe fiduciary duties to company as a whole and "the undifferentiated equity as a collective," not to individual stockholders). "The duty to act for the ultimate benefit of stockholders does not require that directors fulfill the wishes of a particular subset of the stockholder base." *In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 36 (Del. Ch. 2013).

In fact, contrary to Plaintiff's allegations, Lodzinski's connections to Oak Valley aligned him with Earthstone—not Bold—because Oak Valley owned 41.1% of Earthstone ***but had no ownership interest in Bold***. *See* A40-41, 49, 60-62, 254; *Chen v. Howard-Anderson*, 87 A.3d 648, 670–71 (Del. Ch. 2014) ("no conflict" if "the interests of the beneficiaries are aligned"). Lodzinski by no means sat on both sides of the Transaction. *See Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 362 (Del. 1993) (fiduciary is conflicted if he "appear[ed] on both sides of a transaction").

Further, it is undisputed that Oak Valley, a passive entity, paid Lodzinski no salary or benefits following its 2014 merger with Earthstone. There is no allegation that EnCap could threaten Lodzinski's compensation at Oak Valley (there was none to threaten) or employment and compensation at Earthstone. *See Wayne Cty. Emps.' Ret. Sys. v. Corti*, 2009 WL 2219260, at *9 (Del. Ch. July 24, 2009), *aff'd*, 996 A.2d 795 (Del. 2010). Indeed, Plaintiff does not allege that EnCap did anything to control, influence, or coerce Lodzinski in connection with the Transaction. Plaintiff's allegations thus fail to render Lodzinski conflicted.

2. Even if Lodzinski had a material conflict, the Special Committee was not grossly negligent.

Even if Lodzinski were beholden to EnCap (he was not), the Special Committee was not grossly negligent for involving him in negotiations. First, "it can hardly be viewed as remarkable that a chairman and CEO with Lodzinski's

proven track record and expertise...would have exploratory discussions with a potential merger partner before the formation of the Special Committee and then spearhead negotiations." *Olenik*, 2018 WL 3493092, at *20. Established Delaware law supports that view. In *Hamilton Partners, L.P. v. Highland Capital Management, L.P.*, 2014 WL 1813340, at *3, *16–17 (Del. Ch. May 7, 2014), the court held that a plaintiff had failed to adequately allege that a conflicted CEO "dominated or controlled the Special Committee" even though the plaintiff alleged that the conflicted manager "injected himself" in a special committee's negotiations with its counter-party. *Id.*; *see also In re NYMEX S'holder Litig.*, 2009 WL 3206051, at *7 (Del. Ch. Sept. 30, 2009) ("It is well within the business judgment of the Board [or Special Committee]...to delegate the task of negotiating to the Chairman and the Chief Executive Officer.").

And Delaware courts are even more reluctant to find gross negligence in circumstances where, as here, the Special Committee is aware of the CEO's involvement and alleged conflict. In *In re OPENLANE, Inc. Shareholders Litigation*, 2011 WL 4599662, at *5 (Del. Ch. Sept. 30, 2011), the court focused on the fact that "[t]he Board was aware of [the CEO's alleged conflict and involvement] and was fully committed to the process" to conclude that the CEO's involvement "d[id] not taint the process." Other cases are in accord. *See City of Miami Gen. Emps. v. Comstock*, 2016 WL 4464156, at *21-22 (Del. Ch. Aug. 24,

2016) (dismissing claims where allegedly conflicted managers led negotiations and attended special committee meetings because "plaintiff does not allege...that the critical deal terms [the CEO] negotiated...were hidden from the board."), *aff'd*, 158 A.3d 885 (Del. 2017); *In re Plains Expl. & Prod. Co. Stockholder Litig*., 2013 WL 1909124, at *5 (Del. Ch. May 9, 2013) (rejecting claims regarding a purportedly conflicted CEO leading negotiations because "the Board properly managed the conflict by overseeing the negotiations").

Second, Plaintiff's allegations simply do not support an inference that Lodzinski's involvement undermined the negotiations. Although Plaintiff alleges that Lodzinski held preliminary discussions with Bold before the Special Committee was formed, Op. Br. at 38–39, such preliminary discussions are expected under Delaware law, *see, e.g.*, *Comstock*, 2016 WL 4464156, at *2–3, *21; *see also In re Netsmart Techs., Inc. S'holder Litig.*, 924 A.2d 171, 189 (Del. Ch. 2007) (declining to find a flawed sales process where company management and its financial advisor conducted due diligence and signed a confidentiality agreement with a potential target "without the Special Committee's involvement" and before the formation of the special committee).[5]

[5] Nor does Plaintiff plausibly allege that Lodzinski caused Earthstone to act on a timeline that advantaged Bold at Earthstone's expense. Rather, the Complaint alleges that EnCap marketed and hoped to sell Bold in late 2015, but Earthstone's management discontinued its preliminary discussions at that time due to market conditions. *See* A68–71.

Nor did these preliminary discussions "dictate the terms of the transaction" or lock Earthstone into offering or paying a higher price for Bold. Op. Br. at 35, 38. Contrary to Plaintiff's suggestion, Lodzinski did not make an opening bid for Bold; rather Earthstone's management provided preliminary presentation materials to Bold that merely "indicate[d] an equity valuation for Bold of approximately $335 million...." A76-77. This valuation was comparable to—in fact, on the very low end—of the range calculated by Stephens for the Special Committee B36. The Special Committee subsequently authorized an opening bid at $325 million—*i.e.*, A91-92. This is not a situation where the Special Committee valued Bold at $200 million but nevertheless offered $300 million because of management. And Plaintiff's allegations are a far cry from the conduct at issue in *In re Jefferies Group, Inc. Shareholders Litigation*, C.A. 8059-CS (Del. Ch. Nov. 4, 2013) (TRANSCRIPT), where the special committee failed to monitor price negotiations, delayed meeting and hiring its financial advisor for a month after its formation, and determined the transaction exchange ratio in a single meeting. To the contrary, the Earthstone Special Committee "acted swiftly, diligently monitored the negotiations and actively deliberated the terms of the Transaction with the guidance of its

independent advisors early on and throughout the process." *Olenik*, 2018 WL 3493092, at *21 n.260.[6]

[6] Plaintiff's citations to *Kahn v. Tremont*, 694 A.2d 422 (Del. 1997); *McPadden v. Sidhu*, 964 A.2d 1262 (Del. Ch. 2008); *Crescent/Mach I P'rs, L.P. v. Turner*, 846 A.2d 963, 982 (Del. Ch. 2000), are likewise inapposite. In *Tremont*—unlike here—the special committee was neither "fully informed" nor "active." 694 A.2d at 429. And *McPadden* and *Crescent* concerned dissimilar circumstances where (1) the individuals permitted to negotiate the transactions had a self-interest contrary to the company's interest and (2) the ultimate transactions were unfair. *McPadden*, 964 A.2d at 1271; *Crescent*, 846 A.2d at 982.

III. The Proxy did not omit any material information.

A. Question Presented

Whether the Court of Chancery erred in rejecting Plaintiff's disclosure allegations as a matter of law. B169–70, B199–201, B266–70.

B. Scope of Review

This Court's review of a trial court's grant of a motion to dismiss is *de novo*. *Caspian Alpha*, 93 A.3d at 1205

C. Merits of the Argument

1. The Proxy disclosed all material information.

The trial court correctly determined that the stockholder vote was informed and uncoerced because the Proxy disclosed all material information. *Olenik*, 2018 WL 3493092, at *21–24. Delaware law requires only that proxy statements disclose "material information within the board's control." *Stroud v. Grace*, 606 A.2d 75, 84 (Del. 1992). Omitted information is material only if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information." *Malpiede v. Townson*, 780 A.2d 1075, 1086 (Del. 2001) (citation omitted). An "omitted fact is not material 'simply because it might be helpful.'" *In re Micromet, Inc. S'holders Litig.*, 2012 WL 681785, at *10 (Del. Ch. Feb. 29, 2012) (citation omitted). This standard is particularly onerous where, as here, the "total mix of information" is extensive. *See In re Cogent, Inc. S'holder Litig.*, 7

A.3d 487, 509-11 (Del. Ch. 2010). Plaintiff's disclosure allegations fall short of this bar, and the Court of Chancery correctly rejected them as a matter of law.

(a) No material information was omitted regarding the Stephens fairness analysis.

The Proxy did not omit material information concerning Stephens' contribution analysis, one of numerous financial analyses conducted by Stephens. According to the Complaint, an early Stephens presentation showed Earthstone's and Bold's anticipated contributions to the post-combination entity's 2017 and 2018 revenues and EBITDA; the final presentation showed (in separate rows) the parties' contributions to the post-transaction entity's 2017, 2018, ***and 2019*** revenues and EBITDA. A103–05. Plaintiff claims that the Proxy failed to disclose that "after Stephens's initial contribution analysis revealed that a 60/40 ownership split favoring Bold was unfair to Earthstone, the Special Committee (i) directed Stephens to change its analysis to support the Transaction, and (ii) did so despite Stephens's express warning that revising the analysis in that manner would 'provide less meaningful results[.]'" Op. Br. at 42 (citing A88-89, A103, A105-06, A112-13).

Defendants had no obligation to disclose "plaintiff's characterization of the facts" or "draw inferences" in the Proxy. *Seibert v. Harper & Row, Publishers, Inc.*, 1984 WL 21874, at *6 (Del. Ch. Dec. 5, 1984); *In re Best Lock Corp. S'holder Litig.*, 845 A.2d 1057, 1074 (Del. Ch. 2001). The Special Committee's

request that Stephens add 2019 projections to its contribution analysis "made sense given that Earthstone was mature and fully functioning while Bold had not yet exploited its vast oil and gas properties," and the "real benefit of the Transaction to Earthstone—the deal thesis from the outset of the process—was that Bold had untapped resources to which Earthstone could deploy its upstream development capabilities." *Olenik*, 2018 WL 3493092, at *19. Indeed, as the Complaint concedes, (1) "the results of the contribution analysis [are] not as relevant when a mature company [is] buying acreage from a less mature company," (2) Bold was an "early-stage oil and gas…company whose assets consisted principally of undeveloped acreage," and (3) Earthstone was "a mature…company with strong cash flows" in the near-term. A41, 104–05. Further, contrary to Plaintiff's appellate brief, the Complaint does not allege that Stephens told the Special Committee that "revising the analysis in that manner would 'provide less meaningful results[.]'" Op. Br. at 42 (quoting A103). Instead, the Complaint simply notes the unremarkable: Stephens informed the Special Committee that "***sometimes using estimates that are further out could*** provide less meaningful results." A103 (emphasis added). Plaintiff may infer nefarious motives from these unremarkable actions, but Defendants were "not obligated to characterize the progression of Stephens' analysis in a particular manner, or to disclose all iterations" of that work. *Olenik*, 2018 WL 3493092, at *22.

Further, "Delaware courts have held repeatedly that a board need not disclose specific details of the analysis underlying a financial advisor's opinion." *In re Best Lock*, 845 A.2d at 1073. Rather, Defendants were only required to—and did— provide a "fair summary" of Stephens' analysis. *In re Cogent*, 7 A.3d at 511. Earthstone stockholders were given the entire contribution analysis, which showed that Earthstone (who received 39% of the combined entity's stock) was projected to contribute 45% of the combined entity's 2017 EBITDA, 40% in 2018, and 30% in 2019. A311. The Proxy similarly contained a summary of Stephens' many other analyses. A301–14. Earthstone stockholders thus could have "protect[ed] themselves at the ballot box by simply voting no" if they did not believe the contribution analysis (or any of the other analyses) supported a 60/40% split. *Corwin v. KKR Fin. Holdings LLC*, 125 A.3d 304, 313 (Del. 2015).

Plaintiff's reliance on *In re Orchard Enterprises, Inc. Stockholder Litigation* is misplaced. There, a fact question existed concerning a proxy's accuracy because the plaintiffs successfully called into question whether the special committee's financial advisor relied upon its independent judgment. 88 A.3d 1, 21 (Del. Ch. 2014). But here, Plaintiff has not adequately alleged that Stephens acted against its will, particularly because Stephens "did not regard the relative contribution metrics as meaningful for purposes of its valuation analysis" because of "the difference in the development stages of Earthstone (mature) and Bold (early development)."

A311; *see also* A113–14. Plaintiff has conceded that Stephens independently concluded that the Transaction was highly accretive to Earthstone. A208 n.44.[7]

Plaintiff's allegations are little more than disagreements with the substance of Stephens's analysis, which cannot support a disclosure claim. *See, e.g.*, *Comstock*, 2016 WL 4464156, at *15 (dismissing "allegations [that] restate as disclosure claims plaintiff's substantive arguments regarding Morgan Stanley's [analysis]"); *In re Micromet*, 2012 WL 6817785, at *13.

(b) Plaintiff's arguments about EnCap's purported "motivation" for the Transaction fail.

Plaintiff also claims that the Proxy misled stockholders because it failed to disclose EnCap's alleged "motivations for engineering" the Transaction—*i.e.* that (1) Bold lacked cash and drilling capacity to continue operations, and (2) "EnCap ha[d] reached its total capital commitment" in Bold and was "looking to sell Bold"—which purportedly "gave Earthstone significant leverage to negotiate a favorable deal." Op. Br. at 46 (citing A84). That argument fails for a host of reasons.

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[7] *In re Rural Metro Corp.*, 88 A.2d 54, 104 (Del. Ch. 2014), in which plaintiff alleged that the financial advisor presented "false information" to the Board, does not suggest the alleged omissions here were material. There is no allegation that anything in the Stephens report was false or that Stephens gave an opinion that it did not believe to be true.

First, there was no omission, let alone a material omission. The "Background of the Merger" section of the Proxy begins by explaining that Bold had engaged in a formal sales process and that Lodzinski initiated discussions with EnCap concerning the Transaction only after learning "that a sale of Bold did not occur." A290. The Proxy also contains voluminous information concerning Bold's liquidity issues (an unremarkable issue for an early-stage hydrocarbon producer). *See* A263, 341–49. For instance, the Proxy disclosed Bold's revenues and operating expenses for 2013-2016 (showing net losses for the past four years) and Bold's balance sheet (showing that Bold had only $186,301 in cash, $5.9 million in current assets, and $15 million in current liabilities). A263, 341–42, 388–89.

Even if this information had not been disclosed, Plaintiff's claim would fail. Delaware law does not require parties to disclose "alleged improper motives," *Seibert*, 1989 WL 21874, at *6, or "every detail of negotiations," *McMillan v. Intercargo Corp.*, 1999 WL 288128, at *9 n.27 (Del. Ch. May 3, 1999). Further, Plaintiff's disclosure claim is based on the false premise that EnCap was a controlling stockholder and had the ability to "orchestrate" the Transaction (*infra* §0), and it is an improper attempt to criticize the Special Committee's bargaining through the backdoor of a disclosure claim.

2. The Court of Chancery rightly considered this argument at the Motion-to-Dismiss stage.

Plaintiff also suggests that the trial court erred by addressing his disclosure claims at the motion-to-dismiss stage because questions about materiality typically are too fact-intensive. Op. Br. at 41. But Plaintiff never argued below that the court, as a matter of law, could not consider materiality issues. To the extent Plaintiff makes that argument now—for the first time on appeal—it is waived. *See, e.g.*, *Shawe v. Elting*, 157 A.3d 152, 155 (Del. 2017). And even if that argument were not waived, it lacks merit. This Court has repeatedly held that such issues can be addressed in a motion to dismiss. *See, e.g.*, *Malpiede*, 780 A.2d at 1086 n.35 (collecting cases); *see also Orman v. Cullman*, 794 A.2d 5, 31–32 (Del. Ch. 2002).

IV. Alternatively, this Court should affirm the Court of Chancery's dismissal because EnCap and Oak Valley were not controlling stockholders.

A. Question Presented

Whether the business judgment rule applies because EnCap and Oak Valley were not controlling stockholders, Plaintiff failed to impugn the independence or disinterestedness of a majority of Earthstone's board, and the transaction was approved by the fully informed vote of Earthstone's disinterested stockholders. B180–209, B248–57.

B. Scope of Review

This Court's reviews *de novo* a trial court's order dismissing a complaint. *Caspian Alpha*, 93 A.3d at 120. Although the trial court did not analyze (1) whether EnCap or Oak Valley were controlling stockholders or (2) the independence and disinterestedness of each director Defendant, this Court may rule on matters fairly presented to the trial court, even if the trial court did not. *See Cannelongo v. Fid. Am. Small Bus. Inv. Co.*, 540 A.2d 435, 440 n.5 (Del. 1988) (citing Del. R. S. Ct. 8), *superseded by statute on other grounds as recognized in DiSabatino v. Salicete*, 695 A.2d 1118, 1120 (Del. 1997).

C. Merits of the Argument

1. EnCap and Oak Valley were not controlling stockholders.

Plaintiff failed to allege that EnCap or Oak Valley controlled Earthstone. A stockholder is deemed a controller when it (1) owns more than 50% of a

corporation's voting power (the "bright-line" rule) or (2) "exercises control over the business affairs of the corporation" (the "actual control" test). *In re Crimson Expl. Inc. Stockholder Litig.*, 2014 WL 5449419, at *10 (Del. Ch. Oct. 24, 2014).

(a) EnCap did not own greater than 50% of Earthstone for the entire Transaction.

The first control test—the bright-line rule—is not satisfied because, as Plaintiff concedes, Oak Valley's interest fell from 52% to 41.1% in mid-June 2016—five months before the Transaction. A59-60, 160-61. The bright-line rule applies only where a controller remains a majority owner throughout the transaction process; this doctrine is predicated on the notion that "the controlling shareholder will ***continue to dominate*** the company regardless of the outcome of the transaction. The risk is thus created that those who pass upon the propriety of the transaction might perceive that disapproval may result in retaliation by the controlling shareholder." *In re EZCorp. Inc. Consulting Agreement Derivative Litig.*, 2016 WL 301245, at *12 (Del. Ch. Jan. 25, 2016) (emphasis added) (quoting *Tremont II*, 694 A.2d at 428); *see also PNB*, 2006 WL 2403999, at *9 (doctrine is "premised on the notion that…independent directors and minority stockholders cannot freely exercise their judgment, fearing retribution from the controller."). Because EnCap did not indirectly own a majority interest for the entire Transaction, the bright-line rule does not apply, and Plaintiff must instead proceed under the "actual control" test.

Below, Plaintiff attempted to avoid this result by asserting that EnCap "held more than 50% of Earthstone's voting power for a majority of the Transaction process." A177. The "majority of the process" standard is an invented test for which Plaintiff cited no legal authority. Having to determine what constitutes a "majority of the Transaction process" is precisely the sort of murky analysis that a bright-line rule is designed to avoid. *See generally In re Walt Disney Co.*, 2004 WL 2050138, at *4 (Del. Ch. Sept. 10, 2004) (following "bright-line rule" because a contrary result would "lead to significant uncertainty"). Plaintiff's use of his own test illustrates why it has no place in the bright-line control rule, as he calculates the length of the process by beginning from the initial exploratory discussions in December 2015, without accounting for the three month cessation of discussions. And even assuming that *per se* control could be found based on 50+% ownership for a "majority" of the process, it is undisputed that EnCap held less than 50% of Earthstone when (1) the Special Committee was formed in July 2016, A80; (2) Earthstone submitted the initial offer letter on August 19, 2016, A91–92; (3) the Special Committee recommended the Transaction on November 7, 2016, A99–101; and (4) the Board approved the Transaction that same day, A101.

(b) EnCap did not exert actual control over the Transaction.

Plaintiff also fails to allege that EnCap exerted "actual control" over the Transaction. *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1114 (Del. 1994).

Under this second test, Plaintiff must plead that EnCap "exercise[d] such formidable voting and managerial power that it, as a practical matter, [was] no differently situated than if it had majority voting control." *In re Morton's Restaurant Grp., Inc. S'holders Litig.*, 74 A.3d at 664 (citation omitted). The "second test is not an easy one to satisfy and stockholders with very potent clout have been deemed, in thoughtful decisions, to fall short of the mark." *PNB*, 2006 WL 2403999, at *9; *Crimson*, 2014 WL 5449419, at *10–*12 (summarizing cases).

Plaintiff first alleges that EnCap controlled Lodzinski and used that supposed control to steer the Transaction in its favor, but as explained above, these allegations are inadequate. *Supra* §II.C.1.

Plaintiff next attempts to allege control by pointing to a statement in an Earthstone SEC filing that "concentration of stock ownership may...adversely affect the trading price of our common stock to the extent investors perceive a disadvantage in owning stock of a company with a controlling shareholder." A61–62, 642; Op. Br. at 10. But (1) the section containing the statement repeatedly refers to Oak Valley as a ***significant***—not controlling—stockholder; (2) the very next sentence says Oak Valley owned only 41.1%; and (3) the same annual report says that Earthstone "ceased to be a 'controlled company.'" A640–42, 679. Compared to other so-called admissions of control in SEC filings, Earthstone's

statement is insufficient. *E.g.*, *Sciabacucchi v. Liberty Broadband Corp.*, 2017 WL 2352152, at *19 (Del. Ch. May 31, 2017) (stating that the controller is "presumed to control Charter" and will "maintain 'primary control' of Charter.").

Finally, Plaintiff alleges that a majority of the Board was beholden to EnCap, but these allegations also fail. *Infra* §IV.C.2. In sum, the Complaint is devoid of the type of clear allegations of actual control that courts have found sufficient in other cases. *See, e.g.*, *In re Dole Food Co., Inc. Stockholder Litig.*, 2015 WL 5052214, at *5 (Del. Ch. Aug. 27, 2015) (40% stockholder was a controller where he was the company's CEO, "an old-school, my-way-or-the-highway controller" and "responded aggressively" when challenged, including by "forcing [a dissenting director] off the Board"); *Lynch Commc'n Sys., Inc.*, 638 A.2d at 1111, 1114, 1120 (43.3% stockholder was a controller where one of the stockholder's directors "threatened the Committee with a hostile tender offer" and told the controlled company: "[y]ou must listen to us. We are 43 percent owner. You have to do what we tell you."); *N.J. Carpenters Pension Fund v. infoGROUP, Inc.*, 2011 WL 4825888, at *1, *7 (Del. Ch. Sept. 30, 2011) (founder and director holding 37% of company's stock was a controller, where other directors were "cowed by his threats and hostile, erratic behavior"). "Absent a significant showing such as was made in these prior cases, the courts have been reluctant to apply the label of controlling stockholder—potentially

triggering fiduciary duties—to large, but minority, blockholders." *In re Crimson*, 2014 WL 5449419, at *12.

2. A majority of the Board was disinterested and independent from EnCap.

The Complaint failed to impugn the disinterestedness or independence of a majority of Earthstone's eight-member board, as shown below. *Comstock*, 2016 WL 4464156, at *18; *cf Beneville v. York*, 769 A.2d 80, 86-87 (Del. Ch. 2000).

(a) Lodzinski

Most of Plaintiff's lawsuit hinges on his theory that Lodzinski was conflicted and steered the Transaction in Bold's favor, but the Complaint does not adequately plead this theory. *Supra* §II.C.1.

(b) Singleton

Plaintiff's allegations against Singleton fail for the same reasons. Singleton's purported lack of independence from Lodzinski is irrelevant because Lodzinski was disinterested and independent. *Supra* §§II.C.1, IV.C.2(a). And Plaintiff has not adequately alleged EnCap's supposed influence over Singleton's employment; Plaintiff's conclusory assertion that Singleton "works at the behest of EnCap," A124, is not supported by the facts alleged. Further, Plaintiff's circular theory "conflat[es] a pleading that a majority of the Board lacked independence from an interested party[] with a pleading of actual control by that interested party." *Sciabacucchi*, 2017 WL 2352152, at *17.

(c) Joliat and Urban

In evaluating the Special Committee, the trial court correctly determined that Plaintiff failed to impugn the independence of either Joliat or Urban. The complaint points to a "long- running relationship with Lodzinski," their alleged appointment to the Board by EnCap, and their membership interests in Oak Valley. A81–82. But the Complaint does not allege that any of these ties were material to Joliat and Urban. *See MFW*, 88 A.3d at 649; *Comstock*, 2016 WL 4464156, at *18; *In re TriQuint Semiconductor, Inc. Stockholders Litig.*, 2014 WL 2700964, at *3 (Del. Ch. June 13, 2014). Plaintiff does not allege any facts suggesting that Joliat and Urban could not act impartially or "would be more willing to risk [their] reputation than risk the relationship with the interested director." *Beam*, 845 A.2d at 1052.

Allegations that the Special Committee's "economic interests in Oak Valley...depend upon the leadership and financial backing of Lodzinski and EnCap" and that the Special Committee "owe[s] their Earthstone Board seats to Lodzinski and EnCap" are insufficient to state a claim. A81; *see also Aronson*, 473 A.2d at 816 ("[I]t is not enough to charge that a director was nominated by or elected at the behest of those controlling the outcome of a corporate election. That is the usual way a person becomes a corporate director."). Moreover, as previously explained, Joliat and Urban's ownership in Oak Valley aligns their interests with

those of the Earthstone's stockholders. *Supra* §§II.C.1, IV.C.2(a). Also, because Lodzinski was independent of EnCap, their relationship with him says nothing about their independence from EnCap. *See id.*

Plaintiff's additional allegations regarding Urban—that he is CEO of the Vlasic Group, which has invested in companies led by Lodzinski—do not raise a reasonable inference that Urban lacked independence. A81–82, 125–26. It is unreasonable to infer that Urban, as CEO of an investment group, lacks independence from Lodzinski, an executive of the companies in which the group invests. It is similarly unreasonable to infer that Urban lacks independence because certain Vlasic family members serve on the boards of EnCap portfolio companies, particularly given the absence of materiality allegations. "Allegations that directors 'moved in the same social circles,' 'developed business relationships before joining the board' or described each other as 'friends,' are insufficient, without more, to rebut the presumption of independence." *Olenik*, 2018 WL 3493092, at *17 (quoting *Beam*, 845 A.2d at 1051).

(d) Kramer

Plaintiff no longer challenges Kramer's independence or disinterestedness and, in fact, has dismissed his claims against Kramer. A52 (noting that Kramer is a non-party).

* * *

Because Plaintiff failed to allege EnCap or Oak Valley's control of Earthstone and failed to impugn the disinterestedness or independence of a majority of the Earthstone board, entire fairness does not apply. *In re KKR Fin. Holdings LLC S'holder Litig.*, 101 A.3d 980, 990 (Del. Ch. 2014), *aff'd sub nom. Corwin*, 125 A.3d 304. And because a majority of Earthstone's disinterested stockholders approved the Transaction in a fully informed, uncoerced vote, the business judgment rule applies, and this Court should affirm the judgment of dismissal. *See Corwin*, 125 A.3d at 305–06.

CONCLUSION

The EnCap and Oak Valley Defendants respectfully request that this Court AFFIRM the Court of Chancery's July 20, 2018 order dismissing the Complaint with prejudice. The EnCap and Oak Valley Defendants also respectfully request any further relief to which they are justly entitled.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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